No. 12,102

IN THE

United States Court of Appeals

For the Ninth Circuit

JOE BALESTRIERI AND COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

OPENING BRIEF OF PETITIONER.

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PERNAU-WALSH PRINTING CO., SAN FRANCISCO

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I.

JURISDICTIONAL STATEMENT.

The petitioner herein, pursuant to Sections 1141 and 1142, I.R.C. petitioned this Court (Tr. 86) on November 1, 1948, to review a decision of the Tax Court of the United States (Tr. 69) entered on August 3, 1948, which determined a deficiency in petitioner's excess profits tax of $25,021.71 for the year 1943. The petitioner's tax return (Tr. 58) was filed with the Collector of Internal Revenue for the First District of California. A notice of deficiency was mailed to petitioner on October 8, 1946 (Tr. 5), and the petition therefrom filed with the Tax Court on January 6,

1947. (Tr. 1.) A hearing was had on the merits on March 25, 1948. The Tax Court entered its memorandum opinion (Tr. 69) on August 2, 1948.

II.

CONCISE STATEMENT OF CASE.

Issue 1.

(a) Condensed statement of ultimate facts and issues.

This controversy involves the question of whether petitioner is entitled to a deduction of $22,229.37 in its excess profits tax return for the year 1943.

On July 26, 1943, petitioner agreed with a party about to borrow money to finance a specified venture (hereinafter referred to as the debtor) that petitioner, in consideration of 50% of the profits of the venture, would guarantee such debtor against "the payment of any losses or deficits that may occur on money borrowed" from a specified creditor in connection with such venture. (Tr. 75-78.)

The venture was undertaken and failed. Petitioner in November, 1943, issued its note to the creditor for $22,229.37 (Tr. 9) being the amount due the creditor after the termination of the venture. (Tr. 79.)

Petitioner deducted the foregoing sum as a loss in its 1943 excess profits tax return. The deduction was disallowed by the Commissioner of Internal Revenue. The Tax Court sustained the Commissioner on the ground that under the agreement stated above peti-

tioner was a guarantor, that petitioner as a guarantor was entitled to recoup any amount paid to the creditor from the debtor, that petitioner had to prove both payment to the creditor and the worthlessness of the debtor's obligation to petitioner within the taxable year before it was entitled to deduct the foregoing sum; and that petitioner had failed to prove both payment and worthlessness.

Petitioner contended before the Tax Court, and now contends, that a contract of guaranty arises only when a third party contracts with a creditor to answer for the debt, default or miscarriage of a debtor and that as the contract herein was between the debtor and petitioner it was not a contract of guaranty nor was petitioner a guarantor.

Petitioner further contended before the Tax Court and now contends that as the substance of the contract between the debtor and petitioner was that petitioner, in consideration of 50% of the profits of the venture, would be liable for certain specified losses of the venture, the debtor and petitioner were joint venturers and that the aforesaid $22,229.37 was petitioner's share of the loss of the joint venture, which loss occurred in the taxable year herein involved.

(b) Specific pertinent facts.

The pertinent facts hereafter stated are taken from the Tax Court's findings of fact unless otherwise noted.

> "Petitioner is a corporation organized in 1941 under the laws of the State of California. Its

business is that of a wholesale dealer in fish. Its corporation income and declared value excess profits tax and corporation excess profits tax returns for the year 1943 were filed, on a cash basis, with the collector of internal revenue for the first district of California." (Tr. 69.)

"Petitioner's capital stock was entirely owned by Joe Balestrieri and W. E. Otto, or by members of their immediate family, Balestrieri was president of petitioner and Otto was vice-president. Both were members of petitioner's Board of Directors." (Tr. 70.)

"In the early summer of 1943, one J. M. Hoff, a mining engineer, approached Otto, in his individual capacity, with a proposition for the mining and milling of chrome ore. Thereafter, Otto introduced Hoff to Balestrieri. In July, 1943, after several conversations and after each had convinced himself that very large profits would be derived from the mining and milling of this ore, the three individuals named (Hoff as party of the first part, Balestrieri as party of the second part, and Otto as party of the third part) executed Articles of Co-partnership, which are incorporated herein by reference, and which provide, in substance, as follows: Each party would have an equal interest in the partnership, which would operate under the name of Strategic Mineral Exploration Co." (hereinafter called Strategic Mineral). (Tr. 70.)

"The profits were to be shared equally between the partners after reimbursing Balestrieri and Otto for any sums advanced." (Tr. 71.)

The uncontradicted testimony of Otto shows that Strategic Mineral treated the mining of chrome ore and the milling of chrome ore as two separate ventures, and that he approached Pacific Vegetable Oil Corporation hereinafter called P.V.O., regarding the financing of only the milling venture. (Tr. 27.) After a conference with one of the officers of P.V.O., Otto on behalf of Strategic Mineral wrote P.V.O. a letter (Tr. 71-72) which may be summarized as follows, and which was headed "Financing chrome ore through plant of the Montrose Mine & Milling Company". The letter opens:

> "This is to confirm conversation wherein you agreed to finance the purchase of Chrome ore and milling and the discounting of the invoices upon the following basis:"

The letter then outlined the payments to be made for the purchase of chrome ore, the cost of milling the same, and the cost of shipping the chrome concentrates to the Metal Reserve stock pile at Sacramento. The letter then outlines the manner in which the invoices for the chrome concentrates would be assigned to P.V.O., and then provides that P.V.O. shall deduct from the amounts collected on the invoices, the costs advanced, and gave instructions as to how the remaining balance of the invoices representing profits should be divided and specifies the share that P.V.O. shall retain of such profits.

> P.V.O. "indicated that it would agree to the proposition outlined by Otto, provided petitioner's Board of Directors would agree to underwrite

any loss which" P.V.O. "might sustain as a result of its discounting any invoices of the partnership." (Tr. 75.)

Thereupon Otto, on behalf of Strategic Mineral wrote to petitioner the following letter (Tr. 75-76):

"July 24, 1943

Joe Balestrieri & Co.
432 Clay Street
San Francisco, California
Gentlemen:

Offer to participate in profits of Chrome Milling Operation to be handled by this partnership in consideration of guaranteeing venture.

With reference to letter written by Otto Sales Company to the Pacific Vegetable Oil Corp. dated July 23, 1943, which was written in behalf of Strategic Mineral Exploration Company, we hereby offer you a one-half participation in any profits that the Strategic Mineral Exploration Company may earn. All as outlined in letter attached hereto.

The consideration for this offer is that your corporation agrees to guarantee the payment of any losses or deficits that may occur on the money borrowed from the Pacific Vegetable Oil Corporation on our chrome milling venture.

In the event that you decide to participate in this venture, please have your Board of Directors ratify same and formally confirm same to us in writing.

Yours very truly,
Strategic Mineral Exploration Co.
WEO;b /s/ W. E. Otto"

On July 26, 1943, petitioner's board of directors met and accepted said offer (Tr. 76-77), and on the same day petitioner by its president, Joe Balestrieri wrote a letter to Strategic Mineral accepting the offer made by its letter of July 24, 1943.

> "Petitioner's Board of Directors having taken this action, the P.V.O. consented to and did discount invoices of the Strategic Mineral in accordance with its proposal outlined in the letter of July 23, 1943." (Tr. 78.)

> "Before the end of the year 1943, Strategic Mineral had lost approximately $39,000. The partners decided to cease operations and to liquidate Strategic Mineral. Considerable bitterness developed between Balestrieri and Otto on the one hand and Hoff on the other. Hoff refused to assume any responsibility for the losses of the Strategic Mineral and 'walked out' on Balestrieri and Otto." (Tr. 78-79.)

> "There was due to" P.V.O., "on account of its financial dealings with" Strategic Mineral, "the sum of $22,229.37. In 1943, Petitioner executed its note in that amount to" P.V.O., "but payments thereon were not made by petitioner until the following year. The other unpaid bills of the partnership, in the approximate sum of $17,000, were paid gradually by Balestrieri and Otto."

Otto testified that the losses in the approximate sum of $17,000 resulted from the mining venture of Strategic Mineral. (Tr. 27.)

Issue 2.

Petitioner employed J. L. Flynn, an attorney, to represent it before the Tax Court. Mr. Flynn signed the petition and answered for petitioner on the call of the setting calendar on March 22, 1948, when the case was set for hearing on March 25, 1948, at 2:00 p.m. In the afternoon of March 24, 1948, William B. Acton, general counsel for petitioner, but not admitted to the Tax Court was advised that Mr. Flynn likewise was not admitted to the Tax Court, and that no person admitted to that Court was prepared to try the case. Mr. Acton advised petitioner to employ Louis Janin and Harold E. Haven, attorneys admitted to the Tax Court, which employment was accomplished on the morning of March 25, 1948. Mr. Haven, who was representing a taxpayer in the case set for 10:00 a.m. on March 25, 1948, at 12:05 p.m. of that day filed petitioner's substitution of attorneys, explained the facts to the Court, and moved for a continuance of the hearing for sufficient time to permit his partner, Mr. Janin, to prepare petitioner's case for trial.

The motion was denied. (Tr. 11-13.)

III.

SPECIFICATION OF ERRORS.

The Tax Court, petitioner believes, made the following errors:

1. The Tax Court erred in holding and determining that the agreement between Joe Balestrieri and Com-

pany (petitioner) and Strategic Mineral Exploration Co. (debtor) was a contract of guaranty by petitioner to Pacific Vegetable Oil Corporation (creditor).

2. The Tax Court erred in failing and refusing to hold and determine that the agreement between petitioner and Strategic Mineral Exploration Co. constituted an agreement of joint venture.

3. The Tax Court erred in deciding that petitioner did not suffer a deductible loss of $22,229.37 in the year 1943, the same being petitioner's distributive share of the loss of the joint venture.

4. The Tax Court erred in failing to find that the Strategic Mineral Exploration Co. was engaged in a chrome mining venture and a chrome milling venture.

5. The Tax Court erred in failing and refusing to follow the unimpeached and uncontradicted testimony of W. E. Otto on the unsupported assumption that such testimony was highly self-serving and was inconsistent with the known facts.

6. The Tax Court abused its discretion by failing to grant the motion of petitioner for a continuance for sufficient time to permit qualified trial counsel, just employed, to prepare for trial.

7. The Tax Court abused its discretion by failing to grant the motion of petitioner for a rehearing in view of the Court's comments as to the inadequacy of the evidence and in view of the Court's refusal to grant qualified trial counsel time to prepare petitioner's case for trial.

8. The Tax Court erred in that its decision is not in accordance with law.

IV.

ARGUMENT.

SUMMARY.

Issue 1.

(a) Petitioner was not a guarantor but on the contrary was primarily liable to P.V.O.

(b) The exchange of letters between petitioner and Strategic Mineral created a joint venture.

(c) Petitioner's distributive share of the loss of the joint venture was $22,229.37, which was a deductible loss sustained by petitioner in the year 1943.

Issue 2.

The Tax Court abused its discretion in refusing to grant substituted counsel time within which to prepare petitioner's case.

ISSUE 1.

(a) Petitioner was not a guarantor but on the contrary was primarily liable to P.V.O.

The Tax Court concluded that the contract made by the interchange of letters between petitioner and Strategic Mineral was a contract of guaranty under which petitioner had only the secondary liability of a guarantor, and the debtor had the primary liability.

The Tax Court further held that Strategic Mineral was obligated to reimburse petitioner for any payments it made to P.V.O. under the terms of the contract. In reaching this conclusion the Tax Court failed to consider to whom the promise of so-called "guarantee" was made. Petitioner's promise was to Strategic Mineral and was to pay "any losses or deficits that may occur on the money borrowed from" P.V.O. "on our chrome milling venture" (Tr. 76). Strategic Mineral in the contemplated transaction was to be the debtor and P.V.O. the creditor.

The fact that the so-called contract of guaranty was between petitioner and Strategic Mineral, the debtor, is the pivotal fact of this case. The Tax Court in its decision entirely overlooked this fact and was misled by the use of the word "guarantee" which does not always indicate a contract of guaranty.

> "The use of the words 'guaranty' or 'guarantee' do not always denote that there is a contract of guaranty. These words are often used, both by courts and by parties, as synonymous with such words as warranty, agree, indemnify, covenant, surety. and when the intent is to denote an original obligation."
>
> 13 *Cal. Jur.* 85-86, Guaranty, Sec. 3.

> "The authorities recognize that the word 'guarantee' is frequently employed in business transactions to describe, not the securing of a debt, but an intention to be bound by a primary and independent obligation."
>
> 24 *Am. Jur.* 876, Guaranty, Section 5.

> "The use of the word 'guaranty' or "guarantee' does not necessarily import a guaranty contract, for these words are often used in the sense of a promise or agreement importing an original obligation on the part of a person executing such contract."
>
> 38 *C.J.S.* 1131, Guaranty, Section 2.

A contract of guaranty, being one to answer for the debt, default or miscarriage of another, is within the statute of frauds and must be in writing.

Civil Code of California, Section 2793;
13 *Cal. Jur.* 104, Guaranty, Section 18;
24 *Am. Jur.* 899, Guaranty, Section 38;
38 *C.J.S.* 1156, Guaranty, Section 18.

The clearest authority that a promise by a third party to a debtor to pay his creditor is not a contract of guaranty will be found in the consideration of whether oral promises of this nature come within the statute of frauds.

The best exposition of the subject is in 49 *Am. Jur.* 438-39, Statute of Frauds, Section 82, wherein it is said:

> "Sec. 82. A promise by one person, although he is in no way liable for an existing debt, made to the debtor for an adequate consideration, to discharge the debt, is not regarded as a promise to answer for the debt of another within the meaning of the statute of frauds. Such rule has been attributed to the principle that the statute applies only to promises made to a person to whom another is answerable, but a more fundamental

reason for the rule is that the promisor, under the circumstances stated, makes the debt his own and becomes the principal debtor.

The accepted view is that the fact that the liability of the debtor still continues does not bring the transaction within the operation of the statute, since in such case, although the liability of the debtor continues, he is liable rather as surety than as principal, the new promisor becoming in effect the principal debtor."

In Volume 2 of the revised edition of *Williston on Contracts,* after stating in section 452, page 1314:

"It is of assistance in the construction of the next provision of the Statute to have in mind the probable purpose of the legislature in providing that promises to answer for the debt of another must be in writing. Why should such promises, more than others, be subject to the requirement? Doubtless because the promisor has received no benefit from the transaction. This circumstance may make perjury more likely, because while in the case of one who has received something the circumstances themselves which are capable of proof show probable liability, in the case of a guaranty nothing but the promise is of evidentiary value. Moreover, as the lack of any benefit received by the guarantor increases the hardship of his being called upon to pay, it also increases the importance of being sure that he is justly charged."

it is stated in Sec. 460, p. 1331:

"Though the words of the Statute" (of Frauds) "are in terms applicable to a promise

made to anyone to pay a debt of a third person, by construction of the Courts which have had in mind the mischief aimed at, the application of the Act has been confined to promises made to the creditor himself. Accordingly, oral promises made to the debtor to assume and pay his debt may be enforced by him, as may an oral promise to lend him money with which to discharge his debts."

In 37 *C.J.S.* 526, it is said:

"An oral promise to discharge the debt of another, if made to the debtor himself is not within the statute of frauds."

In *Page on Contracts,* Section 1234, Vol. 2, page 2156, it is said:

"To be included in this clause of the statute, the promise must be to answer for the debt of 'another'. A promise by A to B to pay B's debt is not a promise to pay the debt of 'another' within the meaning of the statute, even though the ultimate effect of performance by A will be to discharge a debt owing from B to another."

In *Garroway v. Jennings,* 189 Cal. 97, an action against Davis and Jennings for attorney's fees, wherein Davis, in consideration of the assignment of a judgment, promised Jennings to pay the attorney fees which she owed her attorneys for securing said judgment, the Court said:

"The sole ground of demurrer is that the complaint seeks to charge Davis with the debt of Jennings upon an undertaking not in writing.

> The basis of this objection is that the contract alleged against Davis was a contract of suretyship or guaranty which is invalid unless made in writing and signed by the party to be charged. This principle does not apply to a contract of the character alleged in the complaint. *It was not a contract to guarantee or become surety* for the obligation of Jennings, but was an original obligation on his part to pay the debt of Mrs. Jennings directly to her creditors and it was based upon a sufficient consideration, that is, the transfer to him by her of the judgment above mentioned. It comes within the description of such original obligations set forth in Section 2794 of the Civil Code, and it need not be in writing." (Emphasis added.)

We will not further elaborate on this issue by citing the many cases supporting the texts quoted. In fact, we would not have argued this point so extensively, if it were not for the fact that what seemed obvious to us, was not obvious to the Tax Court.

We feel certain that the foregoing authorities are ample to establish that the agreement between petitioner and Strategic Mineral was not a contract of guarantee but one in which petitioner was the only party primarily liable for the repayment of any loss of money advanced by P.V.O. to finance the milling venture. Petitioner was in substance, the real borrower of the money.

Furthermore, the testimony of petitioner's witnesses show that it was the intention of both petitioner and Strategic Mineral that petitioner become the primary

obligor (see testimony W. E. Otto Tr. 27-30, 37-38 and Joseph Balestrieri Tr. 47, 50-51).

The misinterpretation of the contract between petitioner and Strategic Mineral makes the entire decision of the Tax Court erroneous, both as to statement of general legal principles and as to the application of the law to the facts. Such error requires a reversal of the decision of the Tax Court and the proper application of the law by the Court of Appeals for the Ninth Circuit to the facts found by the Tax Court. The balance of the argument on this issue is devoted to the discussion of the true legal significance of the facts so found.

(b) The exchange of letters between petitioner and Strategic Mineral created a joint venture.

The pertinent facts to be considered in determining the legal relationship of the parties are:

1. Strategic Mineral had a proposition for the mining and milling of chrome ore out of which they expected to make very large profits (Tr. 70). The proposition had two features, one was the mining of the chrome ore and the other was the milling of the chrome ore. (Tr. 27.)

2. The milling part of the proposition contemplated the purchase of chrome ore, the milling of the same and the shipment of the chrome concentrates to the Metals Reserve stockpile at Sacramento, California. (Tr. 72.)

3. To finance the milling venture Strategic Mineral proposed to P.V.O. that it advance the money

necessary to finance the purchase, milling and shipment of the chrome ore, P.V.O. to be protected by the assignment of the invoices for the chrome concentrates shipped and to receive certain percentages of the profits of the milling venture. (Tr. 71-74.)

4. P.V.O. agreed to finance the milling venture provided petitioner would agree to "underwrite" any loss which it might sustain as a result of its discounting any invoices of the milling venture. (Tr. 75.)

5. Thereupon Strategic Mineral by letter offered petitioner a one-half participation in any profits Strategic Mineral may earn in the milling venture, in consideration that petitioner "agrees to guarantee the payment of any losses or deficits that may occur on the money borrowed from" P.V.O. "on our chrome milling venture." Petitioner accepted this offer by letter after such course of action was approved by its Board of Directors. (Tr. 75-78.)

6. W. E. Otto and J. Balestrieri were two of the three partners of Strategic Mineral (Tr. 72) and petitioner's capital stock was entirely owned by them or by members of their immediate families. Balestrieri was president of petitioner and Otto, vice-president. (Tr. 70.)

In the preceding subdivision of this argument we have already established that the contract formed by the interchange of letters between petitioner and Strategic Mineral made petitioner primarily liable for the payment to P.V.O. of any moneys advanced which were not recovered from the discounted invoices.

P.V.O. could have sued petitioner directly upon its contract with Strategic Mineral because in California, as in most states, a third party may sue upon a contract made for its benefit. Section 1559 of the Civil Code of California provides:

> "A contract made expressly for the benefit of a third party, may be enforced by him at any time before the parties thereto rescind it."

By virtue of this provision of the Civil Code of California, the agreement between petitioner and Strategic Mineral did in fact underwrite the advance of P.V.O. in a manner which must have been more satisfactory to P.V.O. than if petitioner had guaranteed the account of Strategic Mineral. This, because petitioner was primarily liable to P.V.O. instead of secondarily liable. When it is considered that it has been stipulated that P.V.O. made the advances that it did, only because it was protected by the foregoing so-called "guarantee" contract of petitioner (Tr. 23) it becomes apparent that petitioner and not Strategic Mineral was the real borrower of the money from P.V.O. which was lost in the milling venture.

This being so, what relationship was created between petitioner and Strategic Mineral by the contract formed by their exchange of letters? There seems to be but one logical answer to this question and that is that they were joint adventurers.

As stated in 14 *Cal. Juris.*, 760:

> "A joint adventure may be defined to be a joint association of persons in a common enterprise

for profit, but falling short of a partnership * * *."

The essence of the agreement between petitioner and Strategic Mineral was that petitioner, as its contribution to the joint venture, would supply the necessary finances through borrowing and that Strategic Mineral as its contribution would supply the milling venture from which great profits were expected, and manage the same. Each was to receive 50% of the profits and if there was a loss each was to lose the contribution, each had made. What is this if it is not a joint venture?

The money to be borrowed from P.V.O. was to be payable to Strategic Mineral because the venture was to be operated in its name. However, when we consider that W. E. Otto and J. Balestrieri were not only the officers of petitioner but also its stockholders and that said Otto and Balestrieri were two of the three partners of Strategic Mineral, it must be held that the management and control of the venture was as much in the hands of petitioner as it was in the hands of Strategic Mineral.

Every element of a joint venture is present. The parties share the profits and risk their contributions to the venture. Furthermore, there is a common control of the management of the venture.

In *Butler v. Union Trust Co.*, 178 Cal. 195; 172 Pac. 601, it was held that a joint venture exists where a furrier agrees with a merchant to devote his labor and skill in the manufacture of fur garments, the

merchant to furnish the capital, pay the furrier a salary, and the two to divide the remaining profits.

In *Champagne v. Passons,* 95 Cal. App. 15, 27; 272 Pac. 353, it was held that an oral agreement that defendant should furnish the money necessary to buy certain land and the equipment necessary to develop it and that plaintiff should devote his time for three years to the development of the land in accordance with defendant's directions, the parties to divide the profits and defendant to lose his investment and plaintiff his time in case the land was washed away by floods, was held to be an agreement of joint adventure and plaintiff was held to be entitled to an accounting of profits.

As far as tax law is concerned, the decisions are not any too definitive, for the most part, and this is particularly due to the fact that joint ventures were not included in the definition of partnership prior to the Revenue Act of 1932. What is probably the leading appellate tax case is *Tompkins v. Commissioner,* (C.C.A. 4, 1938) 97 Fed. (2d) 396.

In the *Tompkins* case a partnership and a corporation together purchased an office building, subject to a deed of trust, the partnership to have a 3/5ths interest. The corporation incurred financial difficulties and was unable to pay its pro rata of costs and expenses. The partnership acquired the property on foreclosure sale, and the Commissioner and Board of Tax Appeals held that it sustained no loss. The Circuit Court, however, held that the joint venturer

had sustained a loss, and the partnership was entitled to the deduction claimed.

See also:

James F. Curtis, 3 T.C. 648, 661;
Roland L. Taylor, 44 B.T.A. 370.

The fact that losses are to be shared in a different manner than profits is of no importance and does not militate against the existence of a joint venture or partnership.

Thompson & Black, 11 B.T.A. 729.

In this case as to one partnership undertaking, one of the partners agreed to stand all losses, but both partners were to participate in any profits. It was held that the loss was a partnership loss, even though it would be entirely utilized in reducing the distributive share of the income of the one partner.

A similar result is fairly common where under a partnership agreement one or more of the partners is to be paid a salary which is to be treated as an operating expense and not as an advancement, and where such "salaries" exceed net income and result in a depletion of the capital of the partners. Under such circumstances the partners are allowed to deduct the loss represented by the depletion of their capital.

Augustine M. Lloyd, 15 B.T.A. 82, 85.

The case of *Kenneth Walsh,* 38 B.T.A. 368, 377, is particularly pertinent, although it illustrates the negative side of the problem. In this case the taxpayer claimed that a loss had been sustained by a partner-

ship of which he was a member and that he was entitled to deduct the same pro rata of that loss as was his pro rata interest in the profits. However, under the partnership agreement, this loss was solely that of partners other than the taxpayer. The Board of Tax Appeals held that the loss was not his, and his claim for deduction there denied.

See also:

Charles C. Hood, 19 B.T.A. 962, 965;

Lederer v. Parrish, 16 Fed. (2d) 928; (C.C.A. 3, 1927, rev'g *Parrish v. Lederer,* 14 Fed. (2d) 987).

We believe that the foregoing authorities clearly establish that petitioner and Strategic Mineral were joint adventurers.

(c) Petitioner's share of the loss of the joint venture was $22,229.37, which loss was sustained in the year 1943 and was deductible in that year.

The Tax Court having misinterpreted the contract between Strategic Mineral and petitioner, failed to find as to the foregoing joint venture in milling chrome and also failed to find that Strategic Mineral was separately interested in a chrome mining venture. It did, however, find that before the end of 1943 Strategic Mineral had lost approximately $39,000; that it ceased operations and was liquidated; that there was due P.V.O. $22,229.37; that petitioner gave its note in 1943 to P.V.O. for that amount; and that the other unpaid bills of Strategic Mineral in the approximate sum of $17,000 were paid by Otto and

Balestrieri as partners in Strategic Mineral. (Tr. 78-79.)

The Tax Court having found a total loss of approximately $39,000 of which the indebtedness to P.V.O. was a part, these findings are sufficient to determine petitioner's share of the loss in the joint venture and it becomes immaterial whether the other indebtedness of approximately $17,000 was a further loss of the joint venture or was lost by Strategic Mineral in its mining venture. By the joint venture agreement petitioner's loss in such joint venture was limited to the loss of money borrowed from P.V.O. (i.e. $22,229.37).

The enterprise in which the joint venture was engaged is clearly delineated in the letter to P.V.O. (Tr. 71-74) and was the buying and milling of chrome ore and the shipment and sale of chrome concentrates to the Metal Reserve stock pile in Sacramento. W. E. Otto testified on cross examination with respect to the amount owing P.V.O. at the termination of the joint venture as follows:

> "A. Well, that was just figures of what we spent for ore and what we received in concentrates at the mill. That is what we got back, we were just that much short on the operation of the chrome mill.
>
> Q. Was that the amount that was due to the Pacific Vegetable Oil Corporation on the date that you decided to terminate the venture?
>
> A. Yes, sir, yes.
>
> Q. In other words, if the venture had been terminated a few weeks earlier or a few weeks

later, the amount would undoubtedly have been different?

A. A few weeks earlier would have been lots less. We didn't have sense enough to terminate it quick enough, lets put it that way.

Q. Or if Pacific Vegetable Oil had extended a little more credit——

A. It would have been more.

Q. It would have been more?

A. That is right." (Tr. 42-43.)

This testimony, together with the letter to P.V.O. makes it clear that the joint venture had an ordinary net loss in the buying, milling and selling of chrome ore of at least the sum of $22,229.37, which loss under the joint venture agreement was sustained by petitioner in the year 1943, the taxable year before this honorable Court.

Section 2797(a)(2) of the Internal Revenue Code defines a partnership as including a joint venture and Section 182 of said code provides:

> "In computing the net income of each partner, he shall include, whether or not distribution is made to him—
>
> * * *
>
> (c) His distributive share of the ordinary net income or the *ordinary net loss* of the partnership, computed as provided in Sec. 183(b)." (Emphasis added.)

Sec. 183(b) I.R.C. provides for a segregation of capital gains or losses from ordinary net income or ordinary net loss and in no way impairs the right of

petitioner to deduct his distributive share of the ordinary net loss of the joint venture.

In conclusion on Issue 1 we submit that the decision of the Tax Court must be reversed and that this Honorable Court should declare that petitioner was entitled to deduct the sum of $22,229.37 in its excess profits tax return for the year 1943 for the reason that said amount represents its distributive share of the ordinary net loss of its joint venture with Strategic Mineral.

ISSUE 2.

THE TAX COURT ABUSED ITS DISCRETION IN REFUSING TO GRANT SUBSTITUTED COUNSEL TIME WITHIN WHICH TO PREPARE PETITIONER'S CASE.

This case was set for trial before the Tax Court on March 25, 1948 at 2 P.M. (Tr. 10-11). William B. Acton, general counsel for petitioner and of counsel for petitioner before this Honorable Court, but not admitted to practice before the Tax Court, discovered on the afternoon of March 24, 1948 that John L. Flynn who had assumed to sign the original petition to the Tax Court, as counsel for the petitioner, was not admitted to practice before that Court, and that he had not arranged for anyone admitted to practice before the Tax Court, to try petitioner's case (Tr. 11). Furthermore, said Flynn had answered for petitioner at the calling of the setting calendar on March 22, 1948. (Tr. 2, 12.) Mr. Acton immediately started a search for counsel admitted to the Tax Court to try

his client's case and contacted Mr. Haven, now of counsel for petitioner, who arranged with his partner, Mr. Janin, to try the case if employed. Employment of substituted counsel was accomplished during the morning of March 25, 1948, and Mr. Haven, who was then engaged in trial before the Tax Court, at 12:05 P.M. on March 25th, advised the Tax Court of the above facts and presented to the Tax Court the appearances of the substituted counsel and petitioner's motion for their substitution as its attorneys. Mr. Haven requested of the Tax Court that the case be continued until the next calendar so that it might be prepared for trial or in the alternative that it be continued for at least one day so that Mr. Janin might partially familiarize himself with the case. (Tr. 11-12.)

The Court replied to Mr. Haven's request as follows:

> "I am sorry, I don't see how I could do anything other than call it just in order, because such a thing is inexcusable. I realize that your office had nothing to do with it, Mr. Haven, but we have to go ahead with it just as soon as we get to it." (Tr. 12.)

We believe that the foregoing action of the Tax Court was extremely arbitrary and constituted an abuse of discretion seriously impairing the right of petitioner to a fair hearing before the Tax Court.

It is true that the action of Mr. Flynn in signing the original petition as counsel for petitioner, in answering the setting calendar as counsel for peti-

tioner, when not admitted to practice before the Tax Court, was inexcusable. Further it was inexcusable on the part of Mr. Flynn, after representing to petitioner that he was qualified to appear in behalf of petitioner before the Tax Court by signing the petition to that Court as counsel, not to have immediately associated counsel qualified to present petitioner's case to that Court. But petitioner should not be deprived of a fair hearing because of the inexcusable action of Mr. Flynn. Petitioner was entitled to assume that when Mr. Flynn undertook to act as its counsel and continued to act as such, he was qualified to do so. Petitioner, as soon as it discovered the facts, acted promptly and could not be charged even with being negligent in the protection of its rights.

The very foundation of the American judicial system—a fair and full hearing—was attacked by the foregoing action of the Court. Proper action would have been to grant a sufficient continuance to permit substituted counsel to prepare for trial and if the Court desired to discipline anyone for having inconvenienced it, that discipline should have been by way of action against Mr. Flynn for assuming to act as a member of the bar of the Tax Court.

The foregoing action of the Tax Court compelled Mr. Janin to attend the 2 P.M. session of that Court on the day he was first employed, in order that he be present to proceed with petitioner's case as soon as the preceding case was concluded. The case was called for trial at 5:30 P.M. on that day. (Tr. 13.)

The books of account of Strategic Mineral containing the records of the joint venture were not found until after the opening of Court on March 26, 1948, at 9:30 A.M. (Tr. 29) and Mr. Janin had no opportunity to examine them until after the conclusion of the case at 10:50 A.M. on said day. (Tr. 54.)

The case was necessarily sketchily presented but we believe we were fortunate in proving all the facts essential to establish petitioner's right to deduct $22,229.37 in its excess profits tax return for the year 1943. However, if this Honorable Court should conclude that petitioner has not fully sustained the onerous burden of proof required to overcome the inference of correctness of the Commissioner's determination as to any particular fact we urge that this case be remanded to the Tax Court for the taking of further evidence on that point because of the foregoing abuse of discretion of the Tax Court in refusing any continuance whatever to permit petitioner's substituted counsel to prepare for trial.

Dated, San Francisco, California,
April 1, 1949.

Respectfully submitted,
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